

**MEMO# 6015**

July 1, 1994

## **SEC POSITION ON MONEY MARKET FUND PURCHASES OF CERTAIN ADJUSTABLE RATE SECURITIES**

July 1, 1994 TO: BOARD OF GOVERNORS NO. 57-94 MONEY MARKET FUNDS AD HOC COMMITTEE NO. 14-94 MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 6-94 SEC RULES MEMBERS NO. 44-94 RE: SEC POSITION ON MONEY MARKET FUND PURCHASES OF CERTAIN ADJUSTABLE RATE SECURITIES \_\_\_\_\_

The Director of the Division of Investment Management has directed the attached letter to the Institute concerning Commission and Division positions on money market funds' management of interest rate risk in compliance with Rule 2a-7 under the Investment Company Act of 1940 and, in particular, on issues relating to adjustable rate securities issued by U.S. government agencies. The letter states that Rule 2a-7 permits money market funds to measure the maturity of adjustable rate securities issued by the U.S. government and its agencies by reference to their interest rate readjustment dates, only so long as the fund and its adviser reasonably expect the value of the security to approximate par upon adjustment of the interest rate. In recent testimony before Congress, SEC Chairman Levitt expressed concern about money market funds holding certain types of adjustable rate securities. The letter describes the types of securities referred to by Chairman Levitt. These include "securities whose interest rate reset provisions are tied to an index that materially lags short-term interest rates, such as 'COFI floaters'." These types of securities had been identified in previous correspondence with the Institute and, most recently, in the SEC's December 1993 release proposing amendments to Rule 2a-7, in which the Commission stated that they involved risks that were "inappropriate for a money market fund to assume." In addition, the letter states that "[i]n analyzing whether a particular adjustable rate security is appropriate for a money market fund, an adviser must determine not only that holding the security is not specifically prohibited by the rule, but also that the security meets the general rule applicable to all investments by a money market fund: that investment in the security is consistent with maintaining a stable net asset value." Money market fund managers are urged to reexamine fund portfolios to determine whether they hold any of the types of securities described in the letter. If so, the adviser is instructed to "consult with the fund's board of directors or trustees about a plan to dispose of the securities in an orderly manner consistent with the best interests of the fund's shareholders." The action approved by the board is required to be memorialized, maintained in the fund's files and made available to Commission examiners upon request. Paul Schott Stevens General Counsel Attachment

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